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# IMPOSSIBILITY AND FRUSTRATION IN SALES CONTRACTS

KIYOSHI IGARASHI\* and LUVERN V. RIEKE\*\*

## I. INTRODUCTION

Legal principles governing sales under Japanese law, a civil rather than common law system, are at some significant points different from the law of the United States. The treatment accorded problems in the two countries involving "impossibility" of performance and "frustration of purpose" present good examples of the differences. Indeed the latter doctrine, "frustration" in the sense of the well-known Coronation cases,<sup>1</sup> may not have a genuine counterpart in the law of Japan.

Historically the differentiation between impossibility and frustration has been difficult enough in the common law, as casual reading of the examples used by Judge Williams in *Krell v. Henry*<sup>2</sup> will illustrate. Japanese law, for reasons which will be illustrated below, has not experienced a similar confusion of these two situations. The American Law Institute's *Restatement of Contracts*<sup>3</sup> provides definitions in section 288 for frustration and in sections 454 through 469 for impossibility which will be useful in this paper. Our objective will be to see the extent to which these doctrines are duplicated in the sales law of the two systems and to see, where no exact counterparts exist, how similar problems are resolved.

## II. IMPOSSIBILITY IN SALES CONTRACTS

In both Japan and the United States, supervening impossibility will often relieve an obligor from the duty to perform an executory, contractual obligation. Some civilian lawyers have called this the rule of *impossibilium nulla obligatio*, and the Japanese Civil Code provides

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<sup>1</sup> The "Coronation cases" arose when the illness of Albert Edward, later King Edward VII of England, forced postponement or cancellation of many public ceremonies and private undertakings. Perhaps the decision in *Krell v. Henry*, [1903] 2 K.B. 740, is the best known of the group.

<sup>2</sup> [1903] 2 K.B. 740.

<sup>3</sup> A source of the *Restatement* with commentary is available to civilian lawyers in Hay, *Zum Wegfall der Geschäftsgrundlage in Anglo-Amerikanischen Recht*, A.C.P. 164, 231.

for the situation, albeit in a somewhat indirect fashion, by the following article:<sup>4</sup>

If an obligor fails to effect performance in accordance with the tenor and purport of the obligation, the obligee may demand compensation for damages; the same shall apply in cases where performance becomes impossible for any cause for which the obligor is responsible.

The significance of this article lies in the negative implication arising from the concluding clause; *i.e.*, inasmuch as the obligor is liable for damages only when performance becomes impossible for reasons *which are the responsibility of the obligor*, it follows that he may *not* be liable for damages arising out of his failure to perform in other cases. The ancient common law point illustrated by *Paradine v. Jane*,<sup>5</sup> a rule of strict liability, is not the law of Japan.

Care must be exercised to distinguish this from a closely related principle, stated as articles 534 through 536 of the Civil Code of Japan,<sup>6</sup> describing the duty of the obligee in such transactions to pay for the "goods" notwithstanding destruction or damage. The latter principle

<sup>4</sup> JAPANESE CIVIL CODE art. 415. [This translation, and those of the Civil Code articles which follow, are taken from 2 Eibun hōreisha Law Bulletin Series No. 2100 (1966), hereinafter cited as EHS.]

<sup>5</sup> Aleyn, 26, 82 Eng. Rep. 897 (K.B. 1647).

<sup>6</sup> JAPANESE CIVIL CODE:

Article 534:

(1) Where the creation or transfer of a real right over a specific thing is made the object of a bilateral contract and the thing is lost or damaged by any cause for which the obligor is not responsible, such loss or damage shall be borne by the obligee.

(2) The provisions of the preceding paragraph shall apply to a contract relating to a non-specific thing as from the time when the thing has become specific in accordance with the provisions of Article 401 paragraph 2.

Article 535:

(1) The provisions of the preceding Article shall not apply in cases where the subject-matter of a bilateral contract subject to a suspensive condition has been lost during the pendency of the condition.

(2) If the thing has been damaged by any cause for which the obligor is not responsible, such damage shall be borne by the obligee.

(3) If the thing has been damaged by any cause for which the obligor is responsible, the obligee may, in the event of the fulfillment of the condition, demand either the performance of the contract or the rescission thereof, at his option; this shall not, however, preclude a demand of compensation for damages.

Article 536:

(1) Except in the cases mentioned in the preceding two Articles, if the performance of an obligation becomes impossible by any cause for which neither of the parties is responsible, the obligor is not entitled to counter-performance.

(2) If performance becomes impossible by any cause for which the obligee is responsible, the obligor shall not lose his right to demand counter-performance; however, if he has received any benefit through being relieved of his own obligation, he shall return such benefit to the obligee.

A quick, if superficial, comparison to United States law on this point can be made by reading UNIFORM COMMERCIAL CODE (hereinafter cited UCC) §§ 2-509, 2-510. [All references to the UCC are to the UNIFORM COMMERCIAL CODE 1962 OFFICIAL TEXT WITH COMMENTS].

deals with the phenomenon which the American lawyer would call the "risk of loss," and is a problem not dealt with in this paper.<sup>7</sup> One must also distinguish the case in which a debt has already come into existence—a matured money obligation—from which the debtor is not discharged by reason of Acts of God.<sup>8</sup> Obviously this is not the same problem as that of the duty of an obligor, in an executory sales contract, whose contemplated performance has been significantly altered by events occurring since the formation of the contract.

The doctrine of impossibility expressed by the Japanese Civil Code was, for a substantial period of time, uncertain in application because of arguments derived from the comparable provisions of the German Code.<sup>9</sup> In particular, it was questioned whether impossibility included only the instances of performance which were physically impossible or also included cases of unusual hardship—the kinds of cases in which the law of the United States excuses performance under the rubric "impracticability because of extreme and unreasonable difficulty, expense, injury or loss involved."<sup>10</sup>

Comparison of the United States and Japanese justiciable law on this issue is difficult because of the paucity of pertinent Japanese case law. Such cases as do exist are illuminating, however, and taken together spell out a pattern of relatively liberal exculpation.

Several of these decisions merit closer scrutiny. The case of *Igarashi v. Igarashi*<sup>11</sup> involved a contract in which the plaintiff was to buy noodles from a manufacturer. After formation of the contract, but before the day set for performance, the buyer obtained a provisional disposition (a specie of injunction) over the seller-manufacturer's equipment. This "provisional disposition" was resorted to in aid of plaintiff's attempt to collect a debt owing him by the seller from another transaction. The consequences, as asserted by the seller, were that he was unable to use his equipment and could not produce nor deliver the noodles by the agreed date.

The court then faced two questions: (1) was it apparent that the parties contemplated the noodles to be produced in the seller's factory and, if so, (2) did the non-availability of the factory under these circumstances relieve the seller's obligation?

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<sup>7</sup> However, see Tanikawa, *Risk of Loss under Japanese Sales Contracts*, 42 WASH. L. REV. 463 (1967).

<sup>8</sup> JAPANESE CIVIL CODE art. 419(2).

<sup>9</sup> For a summary of these arguments, see I LARENZ, *LEHRBUCH DES SCHULDRECHTS* (Treatise on the law of obligations) 230-43 (1963).

<sup>10</sup> See RESTATEMENT, CONTRACTS § 454 (1932); UCC § 2-615.

<sup>11</sup> 26 Minroku 435 (Gr. Ct. Cass., April 5, 1920).

With reference to the first point the Court stated that since it was ordinarily the case for producers of noodles to engage in producing noodles with their own equipment, it must have been the parties' intention in the contract in question, unless a different intention appeared, that the seller produce noodles with his own equipment to meet the buyer's demands.<sup>12</sup> The other point—who was responsible for the unavailability of the equipment—was settled in the producer's favor without discussion. The court thus concluded that the producer was not in breach, because the performance bargained for was made impossible by a circumstance for which the producer was not responsible.<sup>13</sup>

The case of *Gotō v. Shibuya*<sup>14</sup> held that a seller who had promised to deliver rice from Inchon, Korea, to Tokyo, Japan, could not be held liable when the Sino-Japanese War caused such a demand for boats that shipment was rendered "impossible." As in the *Igarashi* decision, it was stressed that this "impossibility" was not one for which the defendant was responsible.

Essentially the same decision as that reached in the *Gotō* case, was announced in *Kan v. Munekata*.<sup>15</sup> The seller in that case found it "impossible" to deliver oil from Japan to China. The court said the delivery was not physically impossible, but that the nonperformance fell into a category of an impossibility for which the obligor was not responsible, when viewed with "an ordinary sense of the society" of those days.

The inability of a shipper to obtain a vessel, even without fault on his part, has not always seemed good reason for discharging him from liability in the opinion of American courts.<sup>16</sup> Even under the more

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<sup>12</sup> A similar conclusion could be reached in the United States, but not quite so painlessly. Indeed some cases such as the casebook favorite, *Whitman v. Anglum*, 92 Conn. 392, 103 Atl. 114 (1918), would go the opposite way. For a discussion of the conflict in American law, see 6 WILLISTON, CONTRACTS § 1952 (rev. ed. 1938). However, UCC § 2-615, comment 5, says the obligor is excused when the source was "contemplated or assumed by the parties at the time of contracting."

<sup>13</sup> Inability to perform because of inadequate finances does not often commend itself as a defense in the United States cases. *Western Drug Supply & Specialty Co. v. Board of Administration*, 106 Kan. 256, 187 Pac. 701 (1920). Under RESTATEMENT, CONTRACTS § 455 (1932), producer's difficulty would probably be called "subjective" and not found to be reason for excuse. It may be that the Japanese court regarded buyer's conduct (the "provisional disposition") as a type of prevention or hindrance of the seller's performance. If so, it is not evident from the report.

<sup>14</sup> HÖRITSU SHIMBUN (No. 4655) 13 (1941) (Korea High Ct., Dec. 3, 1940).

<sup>15</sup> HÖRITSU SHIMBUN (No. 4702) 19 (Japan General Consulate in Sainan, April 26, 1941).

<sup>16</sup> E.g., *Pratt v. Schreiber*, 213 Mo. App. 268, 249 S.W. 449 (1923); *Eppens, Smith & Wiemann Co. v. Littlejohn*, 164 N.Y. 187, 58 N.E. 19 (1900).

liberal provisions of the UCC, the *Gotō* and *Kan* cases would produce interesting debate.<sup>17</sup>

A Japanese court has also had occasion to wrestle with the case of a delayed shipment. The difficult question was how to handle the injury to the buyer, caused by the delay, when the seller, because of an "unavoidable event," could not be held liable for breach. The case involved a German seller whose delivery of a locomotive to Japan was delayed three months by the outbreak of the Russo-Japanese war. The buyer offered to pay the price, reduced by an amount equivalent to the loss allegedly resulting from the delay. This offer was rejected by the seller who demanded, and sued for, the full price. The Japanese court saw the question as one of breach: was the seller liable for damages or not? The contract had a provision excusing liability when nonperformance resulted from "an unavoidable event." The court denied the buyer any reduction in price.<sup>18</sup>

At this juncture the lawyer will search for alternatives. Could the buyer have asserted a defense based upon a partial failure of consideration? Was there an election worked in the buyer's acceptance of a late delivery? Must a Japanese buyer always pay full price for a defective performance when he has no breach action against the seller?<sup>19</sup> These are helpful inquiries because they introduce one to the differences in analysis which lie beneath the seemingly quite similar treatment of the impossibility cases in Japan and the United States. The civilian lawyer, not using the common law concept of considera-

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<sup>17</sup> Were they contracts for the sale of rice and oil, with delivery an incidental aspect, or was delivery "the very heart of the agreement"? See UCC § 2-614, comment 1. The buyer may have had, under the UCC, at least a right to a substitute performance.

<sup>18</sup> Judgment of April 17, 1907, 1 SAIKIN HANREI 74 (Tokyo High Ct.). JAPANESE CIVIL CODE art. 536(1) provides, with certain exceptions, that: "If the performance of an obligation becomes impossible by any cause for which neither of the parties is responsible, the obligor is not entitled to counter-performance." This obviously is a "total failure" situation not applicable to the simple delay in shipment.

<sup>19</sup> The questions are difficult to resolve under either body of law. A buyer who is informed, or who learns, of an actual deficiency in seller's performance, not caused by a breach, usually is put to an election. In common law a "total" failure of consideration is needed for contract rescission—a rule softened somewhat by UCC § 2-616 which permits the buyer to "terminate and thereby discharge any unexecuted portion of the contract" when he learns "of a material or indefinite delay." Failing to act, the buyer may be compelled to accept a substitute performance.

Perhaps the Japanese buyer could have used the mechanism provided by JAPANESE CIVIL CODE art. 541: "If one of the parties does not perform his obligation, the other party may fix a reasonable period and demand its performance, and may rescind the contract, if no performance is effected within such period."

Both the Japanese article and the UCC provision seem intended "to establish ... machinery for providing certainty as to when a supervening and excusing contingency 'excuses' the delay, 'discharges' the contract, or may result in a waiver of the delay by the buyer." See UCC § 2-616, comment.

tion, must ask these questions in other terms.

Naturally enough, the Japanese law recognizes a distinction between a "final" and a "temporary" impossibility situation. A circumstance which may justify delay in performance by a seller may not finally discharge him from the obligation. This was demonstrated in the case of *Clerunce v. Nakahara*<sup>20</sup> where a strike—a temporary disruption—excused the seller's delay although it would not have enabled him to terminate the contract.<sup>21</sup>

Just as the American businessman is prone to do, so the Japanese seller will frequently resort to special terms in the contract to clarify the consequences of "impossibility." A typical provision is as follows:

A party is excused from his obligation if a complete or partial delay of performance, or if the impossibility of delivery of goods as promised in the contract, is caused by a natural calamity, a war, a riot, an insurrection, an amendment, abolition or establishment of laws, an ordinance or disposition by public power, a strike or other acts of dispute, an accident on transport organ, and other Acts of God. In this situation, the part of this contract, concerning which the impossibility in delivery was caused, is considered to have been rescinded.

Up to this point one can find a clear thread of authority in the Japanese Civil Code and, even though they are few, in the decisions. It may be useful to make a few summarizing observations before leaving this relatively secure ground:

(1) The authorities above identify the defense available to the Japanese seller when an event, not his doing and not a circumstance for which he is responsible, makes his performance impossible or (in the United States sense) commercially impractical. This defense, available by implication from Civil Code article 415 or by express term of the contract, is closely comparable to the defense available in the United States law.

(2) When the seller cannot make out such a defense (for example when he is responsible for the circumstance which renders his performance impossible), he is in breach and the injured buyer may either recover damages under article 415, or rescind.<sup>22</sup> It must be emphasized that the buyer's relief, whether rescission or damages, is

<sup>20</sup> HÖRITSU SHIMBUN (No. 2227) 16 (1924) (Tokyo App. Ct., Dec. 28, 1923).

<sup>21</sup> RESTATEMENT, CONTRACTS § 462 (1932), would lead to the same result. "Temporary" impossibility is not the same as "partial" impossibility under either body of law. How to handle the case of indefinite delay is discussed in note 19 *supra*.

<sup>22</sup> JAPANESE CIVIL CODE art. 541, quoted *supra* note 19; *id.* art. 543: "If performance has become impossible in whole or in part by any cause for which the obligor is responsible, the obligee may rescind the contract."

predicated upon a *breach* theory and not a failure of consideration.

(3) Where the seller does have a defense of impossibility, and the buyer accordingly does *not* have an action for breach (neither damages nor rescission) the allocation of any loss is made under the Civil Code articles dealing with "Risk of Loss." These articles place the loss upon the buyer where the goods are "ascertained" and "specific,"<sup>23</sup> unless the contract is subject to an unresolved "suspensive condition."<sup>24</sup> If, however, the contract did not apply to ascertained goods, and none were specified before the impossibility arose, the seller has no claim against the buyer unless the impossibility was the responsibility of the buyer. In the latter event, the seller may demand performance by the buyer but must recognize any mitigation of damages occasioned by the fact that he need not perform himself.<sup>25</sup>

(4) These remedies apply in instances of "final" impossibility.

Most of these principles, at least so far as the results are concerned, are consistent with the law of the United States. Difficulty may be anticipated, however, as one leaves the routine commercial problems and examines the more complex (and obviously rarer) problems clustered around the concept of "frustration."

### III. FRUSTRATION IN SALES CONTRACTS

#### A. Change of Circumstances Principle

It should be apparent that the common law concept of frustration—whether thought of as a defense based upon failure of consideration or as the non-occurrence of an implied condition constructed upon the premise of contemplated value to be obtained by one party to the exchange—will not be found in the civil law: at least not by that name, nor explained in that fashion.

What the civil law does have is the theory of *rebus sic stantibus*.<sup>26</sup> This theory appeared with frequency in the early European cases but was disapproved during the nineteenth century. It was not enacted into code form, because it was thought contrary to the basic principle of *pacta sunt servanda*. The original Japanese code, patterned after the German and Swiss law, contained no mention of the theory.

<sup>23</sup> JAPANESE CIVIL CODE art. 534(1), quoted *supra* note 6.

<sup>24</sup> JAPANESE CIVIL CODE art. 535, quoted *supra* note 6.

<sup>25</sup> JAPANESE CIVIL CODE art. 536(2), quoted *supra* note 6.

<sup>26</sup> This phrase, as used in the civil law, means that a promise (or the promises in a contract) was made upon a tacit assumption that an existing factual situation, which has significance to the undertaking, will remain basically unchanged. It may be thought of as an implied-in-fact condition to the promisor's duty.



Economic problems associated with World War I, and the resulting changes in social and political life, highlighted those inadequacies in the *pacta sunt servanda* principle which had produced the earlier efforts to modify the doctrine. The civil law jurisdictions renewed their interest in the earlier *rebus sic stantibus* decisions. Out of this effort came the *Geschäftsgrundlage* theory in Germany and the concept of *imprévision* in France. By the 1920's the impact of these doctrines was felt in Japan; a legal scholar, since recognized as the leading exponent of the new doctrine, set out an argument for relief from obligation on the theory of *jijō henkō no gensoku*—the “principle of change in circumstances.”<sup>27</sup>

Even though the German cases and scholarship contributed greatly to the Japanese developments, Professor Katsumoto ultimately patterned his concept more nearly after the French theory of *imprévision*. This is reflected in his definition which states essentially:<sup>28</sup>

The change of circumstances theory changes the effect of the law by making it more in accord with the rule of Good Faith. When the change in circumstances occurs, without the fault of either party, between the formation of the contract and the time fixed for performance, and when the change of circumstance was so unforeseeable and of such character that the continuation of the obligation to perform is inconsistent with the rule of Good Faith, then the legal obligation should, because of the change in circumstances, be governed by the principle of Good Faith rather than the stricter law.

This theory won acceptance by the legal scholars of Japan. In a few situations it was enacted into legislation. Perhaps the clearest illustration of legislative use is the set of statutes, relating to leases of land, which provide that the parties may increase or decrease the rent if the agreed sum becomes unreasonable in comparison to rental or sale value of adjacent parcels, or because of changes in the tax laws.<sup>29</sup> Although generally accepted by Japanese legal scholars, Professor Katsumoto's theory was not applied by the Japanese courts for two decades—probably because the issue was never stated in a reported case rather than because the theory was unacceptable to the courts.

It was during the Second World War when the Great Court of Cession applied the “principle of change in circumstances” in *Izumikoji*

<sup>27</sup> KATSUMOTO, *MIMPŌ NI OKERU JIJŌ HENKŌ NO GENSOKU* (Change of circumstances theory in civil law) (1926).

<sup>28</sup> *Id.* at 567.

<sup>29</sup> *Shakuchihō* (Land lease law) art. 12 (Law No. 49, 1921), in 2 EHS No. 2130; *Shakuyahō* (House lease law) art. 7 (Law No. 50, 1921), in 2 EHS No. 2131.

*v. Ichida*,<sup>30</sup> allowing the vendee to rescind a contract for the sale of land. In that case the plaintiff entered into a contract to purchase from the defendant certain land which would be suitable for a factory. At that time plaintiff paid earnest money, and law day for payment of the balance of the purchase price was two years later. Subsequent to execution of the agreement, but prior to law day, a regulation was enacted which required government approval of the purchase price in all land sales. The defendant made timely application for approval in accordance with the regulation. When law day arrived, however, approval had not yet been granted; nor could it be determined at that time whether approval would ever be granted, or what form such approval might take. Because of this change of circumstances, the Court allowed plaintiff to rescind the contract and to recover the earnest money. The Court was of the opinion that it would be unfair to require the parties to be bound by a contract over such an uncertain period.

Thus, the "principle of change in circumstances" has become a recognized part of the Japanese law. There are to this date very few sale-of-goods decisions which mention the doctrine. It has been recognized in general contract disputes however and, as suggested above, has been used frequently in agreements for the sale of land. Since one may reasonably assume that the same application will be made in disputes involving the sale of goods, it becomes important to examine some of the cases.

According to Professor Katsumoto's original thesis, the change of circumstance theory should be applicable only when the changes are so great that insistence upon literal performance would violate the idea of good faith. This idea—unconscionability, in a single word—has become the pivotal thought in the decided cases. An example can be found in *Iguchi v. Ikegami*.<sup>31</sup> The parties had agreed that an existing lease was to be terminated and the premises vacated during October 1943. The lessee did not quit the premises, although frequently requested to do so, and the lessor delayed bringing an action to evict (first as an accommodation to the lessee and later because some United States military personnel were in residence) until 1949. The lessee opposed the lessor's attempt to enforce the agreement to vacate by pleading a change of circumstances; namely, the severe

<sup>30</sup> 23 Minshū 613 (Gr. Ct. Cass., Dec. 6, 1944).

<sup>31</sup> 8 Minshū 448 (Sup. Ct., Feb. 12, 1954).

housing shortage caused by air raids subsequent to the date of the agreement.

The trial court said the lessee, to prevail in his argument, must establish four points: (1) the existence of greatly changed circumstances; (2) unforeseeability; (3) absence of responsibility, or fault, for the change; and, (4) the unconscionable, or lack of good faith, quality of the lessor's demand for performance. The decision, which went against the lessee on the fourth point, was affirmed by the Supreme Court.

Even though applicability of the rule was denied, the case states that if the lessee had prevailed he could have either (1) modified the original promise to vacate, or (2) rescinded the promise entirely.

Other cases in which the principle was discussed dealt with attempts to rescind contracts for the sale of land. In each of these cases the price had been agreed upon before Japan's monetary system experienced the great inflation which accompanied the Second World War, while the date fixed for performance came after the inflation had occurred. The sellers argued that the change in money value was so great that the buyers could not, in good conscience, demand performance at the original price. It was easy to show that conditions had changed greatly and that the sellers were not responsible for the change. Such proof met at least three of the four prerequisites listed in the *Iguchi* case, and the sellers were successful in a group of lower court decisions.<sup>32</sup>

As could be predicted, inflation also produced arguments founded upon the change of circumstances theory in cases of long term debts. Is the creditor in such instances entitled to claim a sum which in terms of buying power approximates the value originally promised, or must he accept payment in the number of money units originally stipulated? Germany had such cases following the First World War, and its Supreme Court allowed an *Aufwertung*—an upward re-evaluation—of debts.<sup>33</sup> However this precedent is virtually unique in legal history and "nominalism" is clearly the usual rule.

Although Japanese creditors faced devastating inflation, the post-war diet declined to adopt special legislation. Denied legislative as-

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<sup>32</sup> *Sawabe v. Satō*, HANREI JIHŌ (No. 210) 27 (1960) (Tokyo Dist. Ct., Nov. 26, 1959); *Wada v. Kamei*, 10 Kakyū minshū 1812 (Osaka Dist. Ct., Aug. 29, 1959); *Munehiro v. Nagae Sangyō K.K.*, 7 Kakyū minshū 741 (Kanazawa Dist. Ct., March 24, 1956).

<sup>33</sup> Judgment of Nov. 28, 1923, 107 Entscheidungen des Reichsgerichts in Zivilsachen 107 (Reichsgericht).

sistance, creditors turned to the courts for aid under the change of circumstances theory. An instance of this type of case involved a bondholder who in 1957, upon maturity of a bond issued in 1934, asked that the Japanese court order the debtor to pay 300 times the face amount of the instrument. The request was denied.<sup>34</sup> Even though Japanese legal scholars generally favor a re-evaluation of debts to compensate for inflation, neither the legislative nor judicial forum has been responsive to requests for such action.

One reason for this intransigence in the inflation cases, at least those in which the credit was extended after the inflation had commenced, was the absence of the one prerequisite which had not received much attention in the land sale inflation cases above. Unforeseeability, it will be recalled, is one of the four requirements. The same deficiency, failure to establish unforeseeability, was critical in another set of facts which came before the Japanese Supreme Court.<sup>35</sup> In 1944 the plaintiff had sold a home to the buyer on time. After the contract had been made, but before performance by the buyer was completed, the plaintiff's own home (not the house sold to buyer) was destroyed in a bombing raid. Seller, contending he would never have sold the house if he had known of the impending destruction of his home, prayed for a rescission. In denying the relief, the Court held that the loss by air raid was foreseeable in 1944 when the contract was made.

Of the four prerequisites to relief, the one most difficult to analyze systematically is the requirement that the demand for literal performance must be unconscionable. A fairer translation of the Japanese, is that the demand must be consistent with the "principle of Good Faith." It will be helpful at this point to observe just how basic to the Civil Code this concept actually is.

Most civil law codes have an article on good faith. Japan was late in enacting an express provision—an interesting fact because the Japanese courts had been borrowing the idea from the German and Swiss provisions for some time. It was not until 1947 that the Japanese Civil Code was amended to include an explicit good faith statement. Article 1(2) now provides: "The exercise of rights and performance of duties shall be done in faith and in accordance with the principle of

<sup>34</sup> *Kōno v. K.K. Nihon Kangyō Ginkō*, 15 Minshū 1602 (Sup. Ct., June 20, 1961). See also Ikuyo, *Civil Law 1961-1963*, *The Japan Annual of Law and Politics*, Nov. 12, 1964, pp. 34-35.

<sup>35</sup> *Suzuki v. Kawanokami*, 8 Minshū 234 (Sup. Ct., Jan. 28, 1954).

trust.” Even though the immediate ancestry of the article is European,<sup>36</sup> the United States has a relative in the provisions of the Uniform Commercial Code.<sup>37</sup>

The good faith rule has an obvious “equitable” flavor, and just as a common law suitor for equity may be denied relief because of laches, so may the Japanese petitioner be denied relief under the principle of changed circumstances when he has “slept on his rights.” This lesson was learned by the owner of a home who contracted to sell for ¥80,000, received ¥20,000 down payment, and could have received the balance due in three months by registering a conveyance. For fourteen months (July 1945 to September 1946), while the value of the yen depreciated dramatically, the seller failed to convey and make his demand. When finally he did act and asked for ¥240,000, instead of ¥60,000, the Court denied relief, noting that although there was a change of circumstance in this case, it was entirely against faith and trust to allow the seller to enjoy the privilege of the principle of change of circumstances since he had already delayed his own performance at the time the change occurred.<sup>38</sup>

The cases reviewed above, involving conveyances, leases, and inflation, comprise almost the entire body of law dealing with this Japanese variety of “frustration.” Only one case has recognized the argument in a sale-of-goods problem.<sup>39</sup> It is a significant decision, however, because the argument based upon the principle was successful and also because it indicates the type of relief available where the doctrine is recognized.

The case dealt with a contract giving plaintiff the exclusive right to sell a manufacturer’s line of fish netting dye. Plaintiff was required to deposit ¥15,000 with the manufacturer who, thus protected, promised to deliver the dye to buyers named by plaintiff. The manufacturing plant and both parties were then (December 1944) in Korea. Plaintiff instructed defendant to deliver 1,300 units of dye to a specified buyer. Defendant managed to deliver 500 units but, because of critical shipping problems, he could not deliver the other 800. At the end of the war in August 1945, the defendant was compelled to dispose of his

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<sup>36</sup> The Japanese application is closer at this point to the German *BÜRGERLICHES GESETZBUCH* art. 242, and further from the French *CODE CIVILE* art. 1134(3), than was the case at an earlier point in history.

<sup>37</sup> UCC § 2-615 is an example of a “good faith” requirement much like the “change of circumstances” principle even though much more limited in scope. Cf. the limited definition of good faith at UCC § 1-201(19).

<sup>38</sup> *Hirai v. Shibata*, 5 *Minshū* 36 (Sup. Ct., Feb. 6, 1951).

<sup>39</sup> *Fujisawa v. Nakamura*, 2 *Kakyū minshū* 146 (Nara Dist. Ct., Feb. 6, 1951).

Korean property and return to Japan. The plaintiff, having made formal demand for performance within twenty days without avail, sued for rescission and damages on the theory of a breach by the defendant.<sup>40</sup> The court found that the manufacturer, so far as the damage claim was concerned, had a defense of impossibility.<sup>41</sup> However, the rescission claim was found to be supportable upon the change of circumstance, without a showing of breach, and was accordingly allowed.

The significance of the case just discussed must not be missed: a disappointed contracting party may have a remedy in rescission (or sometimes in a modification of the contract) on the theory of change in circumstances *even when the defendant is not in breach*. To a common law attorney, who thinks in terms of failure of consideration, this may at first seem fairly unexciting. To appreciate its meaning to the Japanese, it must be kept in mind that in the civil law, obligation is *not* based upon "consideration." The principle of change of circumstance, as a departure from *pacta sunt servanda*, will then be recognized as equally pioneering with Lord Mansfield's development of the "constructive condition" as an exception to the rule of strict liability in the common law.

### *B. Remedies Available upon Application of the Change of Circumstances Principle*

The remaining task is to explore the consequences resulting from the recognition of the change of circumstances theory. For this, we must turn to another group of authorities.

At the outset, one must notice that procedural differences between the legal systems in Japan and the United States account for some of the major variations in application of the "impossibility" or "frustration" doctrines. For example, the principle of change of circumstances can be raised as a basis for relief in a petition for appellate review even though the argument was not introduced in the trial court.<sup>42</sup> The procedural rules of a United States court would, of course, not permit a novel substantive argument at a comparable stage of the trial.

<sup>40</sup> JAPANESE CIVIL CODE art. 541, quoted *supra* note 19, permits the fixing of a time for performance and allows rescission if the performance is not given. Article 415 (quoted in text accompanying note 4 *supra*) establishes an action for damages for obligor's wrongful failure to perform. Lawyers in the United States whose interest is aroused by the availability of both rescission and damages, sometimes thought to be inconsistent remedies, should examine the buyer's remedies under UCC § 2-711.

<sup>41</sup> Cf. text accompanying note 22 *supra*.

<sup>42</sup> Iwanari v. Kurihara, 10 Minshū 342 (Sup. Ct., April 6, 1956).

As the cases discussed earlier demonstrate, the principle of change of circumstances is essentially (if one uses the nomenclature of American law) an equitable and a defensive allegation. Recovery of damages, not available by reason of changed circumstances alone, would depend upon a showing of breach and the action would be maintained under the other, previously described, articles of the Civil Code. The relief available upon successful showing of the change of circumstances will be either rescission or a modification of the contract.

Rescission is the more common consequence. In cases involving a single exchange or sale, rescission is given a retroactive effect and, by provision of Civil Code article 545, restitution is required of any partial performances.<sup>43</sup> By this provision the Japanese code settles one problem which perplexed the English courts in *Chandler v. Webster* and in the *Fibrosa* case.<sup>44</sup> When the contract is for a continuing supply of goods (the installment contract with reciprocal deliveries and payments) and an application of the change of circumstances principle is permitted, the relief will apply only to executory portions of the agreement.

The difficult problem of apportionment of loss when the seller's performance has resulted in loss to him without any enrichment to the buyer seems not to have received attention in Japanese law.<sup>45</sup>

Rescission, as just pointed out, is the usual remedy when literal performance is no longer a right which the promisee will be permitted

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<sup>43</sup> JAPANESE CIVIL CODE art. 545:

(1) If one of the parties has exercised his right of rescission, the other party is bound to restore the former to his original position; however, the rights of third persons shall not be prejudiced thereby.

(2) Interest shall be paid upon any money to be repaid in the case mentioned in the preceding paragraph as from the time when such money was first received.

(3) The exercise of a right of rescission shall not preclude a demand of compensation for damages.

<sup>44</sup> *Chandler v. Webster*, [1904] 1 K.B. 493, was one of the famous "Coronation cases." It held that a hirer of rooms who had paid in advance could not recover despite cancellation of the royal procession which he had intended to view from the rooms. The subsequent case of *Fibrosa Spolka Akcyjna v. Fairbairn Lawson Combe Barbour, Ltd.*, [1943] A.C. 32, overruled the *Chandler* ruling and held that a Polish firm which had contracted to buy machines from an English manufacturer, and had paid a sum in advance, might recover the down payment on a quasi-contractual theory when supervening war made delivery of the goods impossible.

<sup>45</sup> The apportionment issue was the real bone of contention in the *Fibrosa* case, *supra* note 44. The English parliament responded to that decision with the Law Reform (Frustrated Contracts) Act, 1943, 6 & 7 Geo. 6, c. 40, which does permit equitable apportionment at least when buyer has made an advance payment.

If RESTATEMENT, CONTRACTS § 468 (1932), is taken to represent authority in the United States, the manufacturer who has been put to expense of attempted performance is without claim, in the absence of specific contractual provision, unless the buyer has received benefit. This is the exact quandary which produced the Frustrated Contracts Act in England. Whether UCC § 2-615 changes the law in this regard (or makes it clearer at least) is a question discussed in the text *infra*.

to demand. It is not necessarily the promisor's first or only gambit however. The promisor may use the change in circumstances: (1) as a reason for demanding modification of the contract, resorting to rescission if this demand is rejected or, perhaps, (2) as grounds to procure an order by the court modifying the contract without regard to the assent of the obligee. These two possibilities are best understood in the context of illustrative cases.

It has already been observed that the Japanese Civil Code provides that an obligee may fix a time of performance—a final grace period—as a prelude to rescission.<sup>46</sup> This is in keeping with the concept of "good faith," and the same thinking applies when a promisor believes altered circumstances have given him reason to refuse literal performance. His first step, in good faith, may be to propose a modified performance which he believes would now be fair.<sup>47</sup> So, for example, in *Mori v. Mori*<sup>48</sup> a home-owner who, in 1942, had agreed that the promisee would be entitled to purchase the home for ¥24,500 in 1952, could at the latter date reply to the promisee's tender of payment and request for conveyance by demanding a sum (¥3,600,000) which more nearly reflected the current value of the property. Because the buyer refused to modify pursuant to the seller's demand, a demand the court thought reasonable in light of the change in money value, the promisor was permitted to rescind.

This sequence of rescission following obligee's refusal to comply with a reasonable demand for modification is generally accepted as an appropriate consequence of change in circumstances. Indeed it was part of Professor Katsumoto's original thesis. Although the pattern of the *Mori* case has not yet been approved by the Japanese Supreme Court, there is enough authority from decisions of the lower courts and in legal scholarship that such approval seems certain.

Whether the Japanese courts will take the next step—that of ordering a modification to which the promisee refuses to assent, rather than simply allowing rescission when the requested modification is refused—

<sup>46</sup> JAPANESE CIVIL CODE art. 541, quoted in note 19 *supra*.

<sup>47</sup> Cf. UCC § 2-614(1) which, as stated in Official Comment 1 to the section: requires the tender of a commercially reasonable substituted performance where agreed to facilities have failed or become commercially impracticable....(a) reasonable substituted performance tendered by either party should excuse him from strict compliance with contract terms *which do not go to the essence of the agreement*. [Emphasis added.]

The scheme used in the UCC and the Japanese cases is similar. The difference lies in the significant fact that the substitution, under the UCC provision, is permitted only for "incidental matters," not those which go "to the very heart of the agreement."

<sup>48</sup> 6 Kakyū minshū 1698 (Tokyo High Ct., Aug. 26, 1955).



is still open to debate. One court has traveled at least part of this route by ordering an increased payment on the assumption that the buyer would assent if a demand were to be made.<sup>49</sup> In another case<sup>50</sup> the court indicated, in dictum, that it would depart from the demanded modification (a ten-year postponement of an agreement to vacate leased premises) and substitute its own "correction" so that the agreement would be "objectively reasonable." The court thought a five-year extension was justified because of changed circumstances. However there had already been more than five years' delay and so no order was entered. Perhaps the conclusion of this debate will be that modification cannot be effected without mutual agreement. The legal scholarship on the point is divided, and no court has actually granted such relief. On the other hand it will be recalled that this is precisely the result reached by legislation with respect to certain lease problems.<sup>51</sup>

Altogether there are not many decisions applying the principle of change of circumstances; much less is there adequate case precedent in the specific sales of goods area. As we have demonstrated, the Civil Code has no provision directed expressly to the sales problem. In the absence of case and statutory authority it was predictable that parties would turn to express provision in the contract, and this has occurred.<sup>52</sup> One standard sale of goods contract form has the following paragraph:

Each party has a right to make an offer to alter the terms of this contract when conditions become too unreasonable by virtue of rapid price fluctuation or other changes of circumstance. A party has a right to rescind the contract when the other party fails to agree to such an alteration, or when the purpose of the contract can not be preserved by the alteration of the terms.

The American businessman is likely to approach the modification of the Japanese contract with two serious misimpressions.

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<sup>49</sup> Ōba v. Endō, 9 Kakyū minshū 666 (Sendai High Ct., April 14, 1958).

<sup>50</sup> Mizushima v. Yoshiwara, 18 HANREI TAIMUZU 62 (1952) (Osaka Dist. Ct., Oct. 20, 1951).

<sup>51</sup> See note 29 *supra*.

<sup>52</sup> For a general discussion of the theories and cases in this connection, see TANIKAWA, SHŌHIN NO BAIBAI (Sales of goods) 277-81 (1964). UCC §2-616(3) limits the power of the parties to use a clause "made in advance of trouble" to control the consequences of unforeseen circumstances. Presumably the "Good Faith" rule of the Japanese Civil Code would also set limits to how much may be exacted by advance agreement.

The first of these is that there will be a renegotiation with a bargaining, take-it-or-leave-it, environment. This frame of mind springs from a conviction that courts do not write new contracts for the parties. Possibly that bit of dictum is true in American law; it is not a safe premise in Japanese law.

The second misconception is that there will have to be some rearrangement, or new undertaking, of the "consideration" to support the modified promise. Every common-law student, practitioner, and judge knows the frailty of an unsupported executory accord and the painful story of *Foakes v. Beer*.<sup>53</sup> But the entire premise is wrong when the obligation is one based upon the civil law scheme: consideration simply has no role in the Japanese contract. The novice to this reality may learn the hard way that he has no second chance to escape the modification to which he has assented nor, worse yet, any real alternative to either modification or rescission when the contemplated circumstances have changed.

How nearly does the principle of change of circumstances duplicate the principle that a promisor is discharged when, without his fault, "the assumed possibility of a desired object or effect ... [which] forms the basis on which both parties enter into [the contract] ... is or surely will be frustrated ..."?<sup>54</sup> Whether this *Restatement of Contracts* blackletter rule ever represented the decisions in the United States is a fair question, but it was, at the least, the stated rule for some years.

The new formulation is UCC section 2-615, "Excuse by Failure of Presupposed Conditions." This section, we are told by official Comment one, "excuses a seller from timely delivery of goods contracted for, where his performance has become commercially impracticable because of unforeseen supervening circumstances not within the contemplation of the parties at the time of contracting." It is a test of

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<sup>53</sup> 9 App. Cas. 605 (H.L. 1884). Even earlier, the chancellors were commenting about the "most extraordinary peculiarity of the English Common Law, [that the creditor, to bind himself,] could not take 19 s. 6d in the pound; that was *nudum pactum*." *Couldery v. Bartrum*, 19 Ch. D. 394, 399 (C.A. 1880).

This is not the place to rehearse the subsequent history of the rule. The reader will understand that all which may have been true in 1884 cannot be assumed true in 1966. The Uniform Commercial Code abounds in cautionary statements regarding the need for consideration and in some sections provides that none is needed. This is true for UCC § 2-616. The Official Comment says: "No consideration is necessary in a case of this kind to support such a modification." Application of the section is, obviously, not universal.

<sup>54</sup> RESTATEMENT, CONTRACTS § 288 (1932).

"commercial impracticability" to be contrasted with "impossibility, frustration of performance, or frustration of the venture."<sup>55</sup> The words are new, but does the principle remain the same?

The application of such general statements is admittedly difficult. "Hard cases," says the adage, "make bad law," and Judge Cardozo has observed that: "Those who think more of symmetry and logic in the development of legal rules than of practical adaptation to the attainment of a just result will be troubled by a classification where the lines of division are so wavering and blurred."<sup>56</sup> There is considerable force in the arguments advanced by those who contend, in the United States, for "symmetry and logic" and, in Japan, for *pacta sunt servanda*. Nonetheless they seem to have lost the day. The Japanese *jijō henkō no gensoku*, and the "equitable principles in furtherance of commercial standards and good faith" of the Uniform Commercial Code are the guidelines to be observed. There are procedural differences of significance; care must be used in shifting from one system to the other; but the two bodies of law have here found much common ground.

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<sup>55</sup> UCC § 2-615, comments 1, 3.

<sup>56</sup> *Jacobs & Youngs v. Kent*, 230 N.Y. 239, 129 N.E. 889, 891 (1921).